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REVIEW: ECB Cuts Rates In June, As the End of the Easing Cycle Nears

By

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Executive Summary

- **Decision Made:** *The European Central Bank (ECB) delivered another rate cut in June,* i.e *i)* interest rate on the 'main refinancing operations' to 2.15%; *ii)* interest rate on the 'marginal lending facility' to 2.40%; and the key *iii)* 'deposit facility' to 2.00%. Future decisions will be taken meeting-by-meeting, following its usual three-pronged approach about its reaction function confirmed. The decision was "almost" unanimous.
- **Policy Discussion**: *ECB President Christine Lagarde signaled that the central bank is nearing the end of its rate-cutting cycle*, stating the institution is in a "good position" to navigate global uncertainties. Her remarks echoed Isabel Schnabel's recent call for steady rates to avoid stifling growth or overheating the economy. The latest ECB projections lowered the inflation outlook for 2026 but confirmed a return to the 2% target by 2027. Lagarde stressed it's too early to claim victory over inflation, but acknowledged the end of a policy cycle shaped by COVID, the war in Ukraine, and the energy crisis.

  Markets reacted swiftly: the euro surged to a seven-week high, bonds reversed gains, and traders dialled back expectations for further cuts. During the press conference, Lagarde clarifies that "this is not a pause" and further easing may still be possible, hence the market reaction was partly reversed. The rate cut was "almost unanimous," with only one dissent, likely Austria's Robert Holzmann. Schnabel supported the decision despite advocating caution. In April, the ECB dropped the term "restrictive" from its statement, but later clarified this didn't mean policy had eased. Lagarde also noted the neutral rate wasn't discussed this time.

  She reaffirmed her commitment to serving her full term, amid speculation of early departure, and emphasized that strengthening the euro's global role now depends on political action—calling on EU governments and the Commission to deepen capital markets and uphold the rule of law as the foundation to attract investment.
- **Changes to Economic Forecasts**: *Economic growth remains tilted to the downside, while inflation is close to the ECB's 2% target.* Revised projections now see headline inflation averaging 2.0% in 2025, dipping to 1.6% in 2026, and returning to 2.0% in 2027—mainly due to lower energy prices and a stronger euro. Real GDP growth is forecast at 0.9% in 2025, 1.1% in 2026, and 1.3% in 2027. A strong first quarter in 2025 is offset by weaker expectations ahead, with trade uncertainty weighing on investment and exports. Still, higher public spending, rising incomes, and a robust labor market should support medium-term resilience.

Key Picture: European Central Bank Key Forecasts – 2024-2027

		2025f		***2026f***		***2027f***	
	Latest reading	June Projections	March Projections	June Projections	March Projections	June Projections	March Projections
GDP *(real growth, y-o-y)*	1.2	**0.9**	**0.9**	**1.1**	**1.2**	**1.3**	**1.3**
Inflation *(%, y-o-y)*	1.9	**2.0**	**2.3**	**1.6**	**1.9**	**2.0**	**2.0**
Core-inflation *(%, y-o-y)*	2.4	**2.4**	**2.2**	**1.9**	**2.0**	**1.9**	**1.9**
Unemployment *(%, y-o-y)*	6.2	**6.3**	**6.3**	**6.3**	**6.3**	**6.0**	**6.2**

Source: ECB '*Macroeconomic projections*' June *and* March *2025 Note:* Latest readings: 1. GDP for Q4 2024; 2. Unemployment for April 2025; 3. Inflation for May 2025. *Inflation = Harmonized Index of Consumer Prices (HICP).

Analysis

- **DECISION MADE**: *On June 5, the ECB cut its key interest rates, delivered another 25 bps cut.* In line with consensus, and in a "virtually unanimous" decision, the European Central Bank (ECB) cut its main policy rates by 25 bps i.e. its *i)* interest rate on the 'main refinancing operations' to 2.15%; *ii)* interest rate on the 'marginal lending facility' to 2.40%; and the key *iii)* 'deposit facility' to 2.00%.

  In its forward guidance, the ECB stated that the decisions will be still taken meeting-by-meeting, with its usual three-pronged approach about its reaction function confirmed, especially in current conditions of uncertainty. The ECB is not on a pre-set rate path.

  Amid high uncertainty, staff examined how various trade policies might impact growth and inflation under alternative scenarios. These are published alongside ECB staff projections. If trade tensions escalate, both growth and inflation would fall below baseline projections; a benign resolution would raise growth and, to a lesser extent, inflation above the baseline.

  In terms of *Balance Sheet policies,* the APP and PEPP portfolios are gradually and predictably shrinking, as the Eurosystem has stopped reinvesting principal payments from maturing securities.

- **POLICY DISCUSSION:** *Lagarde signals ECB nearing end of rate cuts.* The rate cut was "almost unanimous," with only one dissent—likely Austria's Robert Holzmann, who had previously urged a pause due to EU-US trade tensions. While Schnabel urged caution and a "steady-hand" approach, she did not oppose the move.

  President Lagarde signalled that the ECB is approaching the end of its interest rate-cutting cycle, stating the institution is in a "good position" to navigate the uncertain global environment ahead. This statement echoed recent remarks by Isabel Schnabel, who said in May that holding rates near current levels allows the ECB to assess the economy without stifling growth or overheating it.

  Lagarde's remarks came alongside updated ECB staff projections, which lowered the inflation outlook for 2026 but reaffirmed a return to the 2% target by 2027. While she emphasized it's premature to declare victory over inflation—"there's always another battle," she said—she acknowledged the ECB is nearing the end of a cycle shaped by compounded shocks: COVID, the war in Ukraine, and the energy crisis.

  Initially, the downgraded inflation forecasts supported expectations for further cuts. However, Lagarde's comment that growth could still be revised upward shifted the tone. Markets reacted swiftly: the euro surged to a seven-week high of $1.1490, bond gains reversed, and traders scaled back expectations for another rate cut this year. However, during the press conference, Lagarde clarifies that "this is not a pause" and further easing may still be possible, hence the market reaction was partly reversed, with traders pricing in further cuts for this year.

  In April, the ECB made a notable shift in its communication by removing the reference to monetary policy being "restrictive," which typically signals a dampening effect on economic activity. However, meeting minutes later clarified that this change in wording did not necessarily mean policy had moved out of restrictive territory. In this meeting, Lagarde noted that the "wonderful concept" of the neutral rate wasn't discussed, and in any case it would only apply in the absence of shocks, which instead are abounding in this period.

  Lagarde also reaffirmed her commitment to completing her term at the helm of the ECB, pushing back against speculation about potential early departures amid a turbulent geopolitical and economic backdrop.

  During recent Governing Council discussions, members examined the evolving role of the euro in the global financial system, including its status as a reserve currency. However, Lagarde emphasized that enhancing the euro's international role now depends largely on political actors. She called on EU governments and the European Commission to act decisively—by deepening capital markets, reinforcing the rule of law, and making Europe a more attractive and stable financial environment.

One of the most unexpected developments for policymakers has been the resilience of the euro. Following U.S. tariff threats, many had anticipated a depreciation that would push up import prices and inflation. Instead, the euro strengthened, adding to disinflationary pressures. Lagarde described this outcome as "counterintuitive," attributing it to the uncertainty created by President Trump's erratic trade policies. She stressed that while the ECB does not target exchange rates, it remains vigilant given the fluid and unpredictable global environment.

- **CHANGES TO ECONOMIC FORECASTS:** *Economic growth remain tilted to the downside.* Inflation is near the ECB's 2% medium-term target. According to the latest staff projections, headline inflation is expected to average 2.0% in 2025, 1.6% in 2026, and return to 2.0% in 2027—revised down from March due to lower energy prices and a stronger euro. Core inflation (excluding energy and food) is projected at 2.4% in 2025 and 1.9% in both 2026 and 2027, largely unchanged.

  Real GDP growth is forecast at 0.9% in 2025, 1.1% in 2026, and 1.3% in 2027. The 2025 outlook combines a strong Q1 with weaker expected growth ahead. While trade uncertainty may dampen investment and exports in the near term, increased public investment, rising real incomes, and strong labor markets are set to support medium-term growth and resilience.

- **ECONOMIC ASSESSMENT:** *Trade tensions threaten growth.* The euro area economy grew by 0.3% in Q1 2025, with unemployment at a record-low 6.2% and employment also rising 0.3%. Survey data point to weaker near-term prospects: manufacturing is rebounding—partly due to front-loaded trade ahead of tariffs—while services are slowing. High uncertainty, rising tariffs, and a stronger euro are expected to dampen exports and investment. Nonetheless, the economy remains resilient. A strong labor market, higher real incomes, solid private sector balance sheets, and easier financing—helped by past rate cuts—should support medium-term growth.

  Inflation fell to 1.9% in May from 2.2% in April. Energy inflation remained negative (-3.6%), food prices rose to 3.3%, and services inflation declined to 3.2% after an Easter-related spike. Underlying inflation trends suggest price growth is gradually stabilizing near the ECB's 2% target. Labour cost pressures are easing, with wage growth expected to fall below 3% by 2026–2027. While low energy prices and a stronger euro are pushing inflation down in the short term, inflation is expected to return to target by 2027. Short-term expectations edged up in April due to trade tensions, but long-term expectations remain anchored near 2%.

  Risks to growth remain tilted to the downside. Escalating trade tensions, weaker sentiment, tighter financial conditions, and geopolitical conflicts could depress investment, consumption, and exports. Conversely, easing tensions, higher public investment, and structural reforms could lift growth. Inflation risks are also two-sided. Lower energy prices and weaker demand could drag inflation below target, while supply chain fragmentation, climate shocks, and higher public spending could raise inflation over the medium term.

- **OUR TAKE:** *ECB on hold for now, further cuts still possible.* The fact that the ECB feels to be "in a good place" to navigate the next few months, at the time in which inflation is back below target and expected to fall further in 2026, suggest that, for the time being the ECB can afford to watch the developments in other policy areas outside its control. In particular, before the next GC meeting on July 24th, the ECB will know what happened to the tariff regime on July 9th, when the "pause" in US tariffs will end.

Then the ECB will decide if further easing is warranted or not, including in July itself. With risks still tilted to the downside, it's more likely than not the ECB will have to cut rates again in 2025, if conditions warrant.

- **MARKET REACTION AND IMPLICATIONS:** *Euro gains as Lagarde says ECB is near end of policy cycle after today's cut, while bonds gave up earlier gains.* After the decision, *in money markets*, Euribor futures implied rates fell by up to 7bps in the short-term part of the curve. *In the bond market*, the *2y German Schatz* yield trades around 1.87% up by around 10 bps. The *10y German Bund* yield first fell 5bps to 2.476%, a one-month low. However later rose up to around 2.56%. In the EZ periphery, *Italy's 10y BTP* yield fell to 3.4% touching its lowest level since md-February but then edged up to 3.55%. As for now, the 10y BTP-Bund spread stands at 99 points. *In the currency space,* the euro climbed 0.7% to $1.1495. Traders scaled back expectations for further rate cuts, now only marginally pricing in one more quarter-point reduction this year. *In the equity space,* European stocks rose as traders digested the ECB decision. Both STOXX 50 and Stoxx 600 rose by 0.1%.